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Supreme Court of the United States

OCTOBER TERM—1930.

No. 350.

EDUCATIONAL FILMS CORPORATION OF AMERICA,
Appellant,

against

HAMILTON WARD, Attorney General of the State of New York, and THOMAS M. LYNCH, JOHN J. MERRILL and MARK GRAVES, comprising the NEW YORK STATE TAX COMMISSION,
Appellees.

BRIEF FOR APPELLANT.

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No. 350.

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HAMILTON WARD, Attorney General of the State of New York, and THOMAS M. LYNCH, JOHN J. MERRILL and MARK GRAVES, comprising the NEW YORK STATE TAX COMMISSION,
Appellees.

BRIEF FOR APPELLANT.

Reference to official report of opinion delivered in the Court below.

The opinion in this case in the court below, the United States District Court for the Southern District of New York, appears in the printed record (pp. 53 to 58 inclusive), and is reported in 41 Fed. (2d) 395.

Statement of grounds on which jurisdiction is invoked.

In the "Statement as to Jurisdiction on Appeal", filed on October 13, 1930, in this Court in compliance

with paragraph 1, Rule 12, the grounds on which jurisdiction is invoked are fully set forth, together with the date of the decree in the court below, the nature of the case and rulings made in the lower court, definite reference to statutory provisions under which jurisdiction is invoked, and cases cited in support of jurisdiction.

Statement of the case.

Plaintiff-appellant brought this suit in the United States District Court for the Southern District of New York to restrain the defendants, comprising the New York State Tax Commission, from proceeding with the collection of a tax, based on plaintiff's net income, to the extent ($7,316.51) that the basis of said tax includes royalties received by plaintiff from United States copyrights, on the constitutional ground that copyrights are federal instrumentalities not subject to state taxation.

Federal jurisdiction depends on the existence of the aforesaid federal question.

Equity jurisdiction—which has not been questioned by appellees or by the court below—is based (R., 7 to 10, 48, 49) on the fact that the New York Tax Law does not furnish an adequate remedy at law to the taxpayer to recover back the tax, if paid (see VIII *infra*).

This appeal is from the final decree of the District Court granting defendants' motion to dismiss the bill of complaint, dismissing said bill on the merits, and denying plaintiff's application for interlocutory injunction (R., 58, 59).

The appellant (plaintiff in the court below) is a business corporation organized under the laws of the State of New York (R., 4). It is engaged in business as proprietor, distributor and licensor of copyrighted motion picture productions (R., 5, 44). During the fiscal year in question appellant was the owner and proprietor of

certain copyrights of the United States of America upon motion picture films or productions, which are listed by name, date and number in Schedule "A" (R., 11-40). Some of the copyrights are issued in appellant's name, some in the names of affiliated corporations (see Schedule "A"), but all were and are owned by appellant (R., 5, 44).

During said fiscal year ending June 30, 1929, appellant received income to the extent of $162,588.98 consisting of royalties on said copyrights received from various exhibitors of motion pictures under license contracts under which appellant granted to said exhibitors for specified periods and in specified theatres and localities "a license under copyright" to project and exhibit appellant's copyrighted motion pictures under said copyrights, in consideration of the payment to appellant of specified royalties or license fees (R., 5, 6, 45, 46).

All of said copyright income was received by appellant from exhibitors under uniform printed contracts, of which a form is annexed to the moving affidavit of appellant's treasurer (Exh. "C", opp. R., 46).

Said contract provides, in part as follows:

> "SECOND: (a) The Distributor hereby grants to the Exhibitor, and the latter accepts, a license under the respective copyrights of the several photoplays designated and described in the schedule herein * * * to exhibit * * * each of such photoplays at the said theatre only for the number of successive days in the said Schedule provided * * *.
>
> * * * * * *
>
> "FOURTH: The Exhibitor agrees to pay for such license as to each of such photoplays the fixed sums herein specified * * *.
>
> * * * * * *
>
> "TWENTY-SECOND: This instrument shall be deemed an application for a license under copyright only and shall not become binding until ac-

> cepted in writing without alteration or change by an officer of or any person duly authorized by the distributor * * *."

On October 11, 1929, as required by Section 211 of the Tax Law, appellant duly executed, verified and filed with the State Tax Commission its franchise tax return for its fiscal year ending June 30, 1929, using a printed blank provided for that purpose by the Commission. A copy of the return and annexed schedules is annexed to the bill of complaint (Exh. "B", opp. R., 40).

As required by Section 211 of the Tax Law, and by the official blank, appellant set forth (Exh. "B", item 8) its "entire net income for the fiscal year commencing July 1, 1928 and ending June 30, 1929, as shown by its report to the United States Treasury Department—$231,372.94" (R., 5).

As required by Section 211 (2) of the Tax Law, and by the official blank, appellant reported in Item 14 the following:

> "If the amount reported in (8) is *inaccurate,** *inapplicable*, state the amount claimed to be correct —*$68,783.96* (*See Attached Explanation*)."

Appellant attached to its return (R., 42) a statement entitled "Explanation of Item 14" above referred to in which it set forth that its "corrected net income" after deducting the sum of $162,588.98 consisting of copyright royalties, was $68,783.96, and that "said royalty income was not and is not subject to tax and may not be used as a measure of any tax purporting to be a corporate franchise tax based on or measured by income, under the Constitution of the United States and decisions of the United States Supreme Court."

---

*Note: The word "inaccurate" as thus used in the statute (§ 211, subd. 2) has been construed to mean "not properly to be considered * * * as a basis for state taxation". *Peo. ex rel, Alpha etc. Co.* v. *Knapp*, 230 N. Y. 48, 68, 69.

Thereafter on January 29, 1930, the State Tax Commission overruled appellant's claim that its copyright income should be excluded in computing the said tax and served official notice that it had assessed plaintiff's tax in the sum of $10,411.79 based on its entire net income ($231,372.94) at 4½% (R., 6, 7, 45), which is $7,316.51 more than said tax would have amounted to if said copyright royalties had not been included in appellant's income in computing said tax (R., 6, 46).

The aforesaid ruling of the State Tax Commission was made pursuant to its announced and fixed purpose not to allow, but on the contrary to reject and disallow, any and all claims by corporate taxpayers that income from copyrights, patents, federal bonds and other federal instrumentalities may not (under the federal constitution) be included in the measure of the franchise tax. The Commission further has indicated that it will continue to adhere to said purpose and practice of including, and refusing to exclude, such income in computing such taxes unless and until it be determined by the courts that the constitutional rights of taxpayers are thereby violated (R., 9, 48, 49).

In its bill of complaint (R., 7) to restrain the collection of said tax to the extent of $7,316.51 as aforesaid, appellant asserted that further application to the State Tax Commission for the revision of the assessment would be useless under the circumstances (R., 7 to 10). The Commission, after the commencement of the suit, granted appellant a hearing, and a hearing was accordingly had, and the assessment was affirmed (R., 50, 51).

By stipulation and by the order of the court below the facts as to the aforesaid hearing and confirmation of the assessment were brought in by an amendment of the bill of complaint, and by the same stipulation and order the appellees were deemed to have moved formally to dismiss the bill (R., 50, 51, 52).

After a hearing before three judges pursuant to Section 266 of the Judicial Code, a final decree was entered dismissing the appeal as amended upon the merits and denying plaintiff's application for an interlocutory injunction (R., 58, 59).

Appellant, prior to the commencement of the suit, paid the portion of the tax admittedly due ($3,095.28), and appellees have voluntarily suspended further proceedings to collect the disputed portion ($7,316.51) pending the determination of the appeal to this Court.

The statute whose constitutionality is attacked is Article 9-A of the New York Tax Law, and particularly Sections 208, subdivision 3, 209 and 215, in that, and in so far as, it subjects appellant to a tax based on its income from copyrights of the United States.

Section 209, so far as material here, provides as follows:

> "209. *Franchise Tax on corporations based on net income.*—For the privilege of exercising its franchise in this State in a corporate or organized capacity every domestic corporation, * * * shall annually pay in advance for the year beginning November first next succeeding the first day of July in each and every year an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income, as defined in subdivision three of section two hundred and eight of the tax law, for its fiscal or the calendar year next preceding, as hereinafter provided, which entire net income is presumably the same as the entire net income which such corporation is required to report to the United States, plus any income received as dividends on stocks or any interest received on bonds of any character * * *".

Section 208, subdivision 3 (referred to in Section 209, *supra*), so far as material here, provides as follows:

> "3. The term 'entire net income' means the total net income, including all dividends received on stocks and all interest received from federal, state, municipal or other bonds * * *."

Section 211, so far as material here, provides as follows:

> "211. *Reports of corporations to tax commission.*—Every corporation taxable under this article * * * shall annually on or before July first, or within thirty days after the making of its report of entire net income to the United States treasury department for any fiscal or calendar year, preceding said first day of July, transmit to the tax commission a report in the form prescribed by the tax commission, specifying:
> * * * * * * *
>
> "2. The amount of its entire net income for its preceding fiscal or the preceding calendar year as provided by subdivision three of section two hundred and eight of the tax law * * *. If the corporation shall claim that the return made to the United States treasury department was inaccurate, the amount claimed by it to be the net income for such period shall be specified * * *."

Section 215 provides, so far as material here:

> "215. *Rate of tax.*—The tax imposed by this article shall be at the rate of four and one-half per centum of the entire net income of the corporation * * * determined as provided by this article * * *".

The following excerpts from Sections 214 and 214(a) are quoted merely because of the phrases *characterizing the tax*, which phrases we have italicized:

> "214. *Computation of tax*—If the entire business of the corporation be transacted within the state, the tax imposed by this article, if *imposed UPON the entire net income*, shall be based upon the entire net income of such corporation for such fiscal or calendar year * * *."
> * * * * * * *
>
> "8. If any corporation has been permitted to change the period for which it shall make its report, it shall be *taxed UPON the entire net income*

which has not been used or included in measuring a franchise tax to this state as though the entire net income had been earned within one year."

* * * * * *

"10. It is further provided that * * * any corporation newly organized * * * which is not subject to a *franchise tax ON net income as provided in section two hundred and nine of this article,* shall be subject to the minimum tax * * *."

"If such corporation is subject to a tax under the provisions of this article of the tax law, and it maintains no regular place of business outside of this state, except a statutory office, it shall be *taxed UPON its entire net income,* or entire issued capital stock, or otherwise, as hereinbefore provided."

"214-a. *Taxation of corporations acquiring assets or franchises of other corporations.* If any business corporation shall acquire * * * the franchises of another corporation * * * it shall be liable for and pay all taxes that would have been due * * * and shall be *taxed UPON such combined net income* * * *. The provisions for the minimum tax shall be applied only when under such provisions a tax will result in excess of the amount which would be produced by a *tax ON entire net income* as hereinbefore provided and then in lieu thereof."

The pertinent provisions of the United States Copyright Law (U. S. Code, Title 17; Mar. 4, 1909, c. 320, §§1 and 5; 35 Stat. 1075, 1076; Aug. 24, 1912, c. 356; 37 Stat. 488) are as follows:

"Sec. 1. Any person entitled thereto, upon complying with the provisions of this Act, shall have the exclusive right:

* * * * * *

(d) To perform or represent the copyrighted work publicly if it be a drama or, if it be a dramatic work and not reproduced in copies for sale, to vend any manuscript or any record whatsoever

thereof; to make or to procure the making of any transcription or record thereof by or from which, in whole or in part, it may in any manner or by any method be exhibited, performed, represented, produced, or reproduced; and to exhibit, perform, represent, produce, or reproduce it in any manner or by any method whatsoever;

* * * * * *

"Sec. 5. The application for registration shall specify to which of the following classes the work in which copyright is claimed belongs:

* * * * * *

(l) *Motion-picture photoplays;*
(m) *Motion pictures other than photoplays.*"

The appellant assigns to be here urged the following errors in the record and proceedings in the said case (R., 60, 61).

"1. That the United States District Court erred in denying plaintiff's application for an interlocutory injunction herein.

"2. That the said United States District Court erred in granting the motion of the defendants to dismiss the bill of complaint herein as amended, and in dismissing the same.

"3. That the said United States District Court erred in entering a decree denying plaintiff's application for an interlocutory judgment herein and dismissing the bill of complaint herein as amended.

"4. That the said United States District Court erred in holding and deciding that Article 9A of the New York Tax Law, in so far as it attempts to include in the measure of the tax provided therein, income received by plaintiff from copyrights of the United States is not in contravention and violation of the Constitution of the United States and particularly Section 8 of Article 1 thereof, as imposing a state tax upon income from an instrumentality of the United States and upon means employed by Congress to carry into effect the powers conferred upon it by the Constitution.

"5. That the said United States District Court erred in holding and deciding that the collection of the tax of $7,316.51 imposed pursuant to Article 9A of the New York Tax Law threatened by the defendants comprising the New York State Tax Commission and measured by plaintiff's income in so far as the same includes income from copyrights of the United States should not be enjoined during the pendency of this suit, and permanently, as in violation of plaintiff's rights under the Constitution of the United States and particularly Section 8 of Article 1 thereof."

Summary of argument.

1. That part of appellant's income which consists of royalties from copyrights of the United States, is exempt from state taxation.

2. The tax involved herein, particularly when considered from the standpoint of immunity from state taxation of income from federal instrumentalities, is in substance and practical operation a tax on income.

3. Under the authority of the *Macallen* case (279 U. S. 620) Article 9-A of the New York tax law is unconstitutional in so far as the tax thereunder is based on income from federal instrumentalities.

4. The decisions in *Flint* v. *Stone-Tracy Co.*, 220 U. S. 107, and earlier cases are inapplicable to the New York statute here involved.

5. The fact that the basis of the tax is net income rather than gross income does not justify its inclusion of federal income. Decisions based on that distinction are expressly limited to taxes measured by income from interstate commerce, whose immunity from state taxation has been declared by this Court to be one of degree

only, while immunity of income from federal instrumentalities is absolute, extending to taxes in which net income is either the subject or the basis of the tax.

6. Income from royalties on copyrights *owned* by appellant, including income from those registered in the names of others, as well as income from those registered in appellant's own name, is entitled to exemption from the state tax.

7. All plaintiff's expenses, including those incurred in procuring the exempt income, as well as those incurred in procuring taxable income, are deductible from gross income in calculating that portion of plaintiff's net income which is subject to the tax.

8. Injunctive relief is appropriate because the remedy at law furnished by the New York Tax Law for the recovery back of the tax if paid is inadequate for four reasons: (a) because no interest is allowed; (b) because the statutory right to refund is not certain; (c) because the judicial remedy (certiorari) is not available in the federal courts; and (d) because the prerequisite administrative procedure, as actually applied, is dilatory and uncertain. Neither the appellees nor the court below have questioned the assertion that the legal remedy is inadequate, and that this suit is an appropriate one for the determination of the fundamental constitutional question herein presented.

ARGUMENT.

I.

Since the income upon which the disputed tax is based consists of royalties from United States copyrights owned by appellant, it is immune from taxation by the State of New York.

There were included in appellant's income upon which the disputed tax was based royalties from United States copyrights to the amount of $162,588.98 (R., 5).

Those royalties were all received by appellant from exhibitors of motion pictures under uniform printed contracts by virtue of the following provisions (R., 5, Exh. "C", opp. R., 46):

> "SECOND: (a) The Distributor hereby grants to the Exhibitor, and the latter accepts, a license under the respective copyrights of the several photoplays designated and described in the schedule herein * * * to exhibit * * * each of such photoplays at the said theatre only for the number of successive days in the said Schedule provided * * *.
>
> * * * * * * *
>
> "FOURTH: The Exhibitor agrees to pay for such license as to each of such photoplays the fixed sums herein specified * * *.
>
> * * * * * * *
>
> "TWENTY-SECOND: This instrument shall be deemed an application for a license under copyright only * * *".

Instrumentalities of the federal government may not be taxed by the states.

McCulloch v. *Maryland*, 4 Wheat, 316, 432.

Patents, being federal instrumentalities, may not be taxed by the states.

> *Peo. ex rel. Edison, etc. Co.* v. *Assessors,* 156 N. Y. 417.
>
> *People ex rel. N. Y. etc. Tel. Co.* v. *Neff,* 15 N. Y. App. Div. 8, 13; aff'd. 156 N. Y. 701;

Similarly, copyrights may not be taxed by the states.

> *People ex rel. U. S. Aluminum Co.* v. *Knight,* 174 N. Y. 475.

In the above cited case the New York Court of Appeals said (p. 483):

> "There is no distinction, so far as the right of taxation is concerned, between copyrights and patent rights, and the state has no power to tax either."

In the recent case of *Long* v. *Rockwood,* 277 U. S. 142, affirming 257 Mass. 572, this Court held that the *income* from patents may not be taxed by the states, saying:

> "The power to exclude others (by patent or copyright is) granted by the United States * * * *such instrumentalities* may not be taxed by the States." (Italics ours.)

Chief Justice Marshall in *M'Culloch* v. *Maryland,* (*supra*) said (p. 432):

> "If the States may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax *patent rights;* they may tax the papers of the custom-house; they may tax judicial process; they may tax all the means employed by the government, to an excess which would defeat all the ends of government. This

> was not intended by the American people. They did not design to make their government dependent on the States." (Italics ours.)

The foregoing was merely an elaboration of the much-quoted phrase *M'Culloch* v. *Maryland* (*supra*) (p. 431):

> "The power to tax involves the power to destroy."

> "Recollecting the fundamental principle that the Constitution, laws and treaties of the United States are the supreme law of the land, it seems to us almost absurd to contend that a power given to a person or corporation by the United States may be subjected to taxation by a State."
>
> *California* v. *Pacific R. R. Co.*, 127 U. S. 1, 41.

The New York State Tax Commission has recognized the obvious application of the principle of *Long* v. *Lockwood* to the income of *individuals* from copyrights, in the following ruling:

> "Following the decision of the Supreme Court of the United States in the case of *Long* v. *Rockwood*, 277 U. S. 142, it will be held that royalty income from patents *and copyrights* granted by the United States Government is not subject to tax under Article 16 of the New York State Tax Law * * *." (From Ruling of State Tax Com., March 27, 1929, Prentice-Hall, N. Y. Tax Service, ¶10,843.) (Italics ours.)

All other states having income tax laws, so far as we have been able to ascertain, have similarly recognized, and now apply, the principle that *income from copyrights may not be taxed by a state.*

II.

The tax involved herein, particularly when considered from the standpoint of the immunity from state taxation of income from federal instrumentalities, is in substance and effect and in practical operation a tax on income.

The taxing statute (Sec. 209) commences:

> "*Franchise tax on corporations based on net income.* For the privilege of exercising its franchise * * * every domestic corporation * * * shall annually pay * * * an annual franchise tax * * * *upon the basis* of its entire net income * * *" (italics ours).

After the introductory employment of the phrase "*for* the privilege * * *" in Section 209, that phrase is not again employed throughout the entire rather lengthy statute (Article 9-a). Whenever the *nature* of the tax is referred to, the expression "tax upon the *basis* of net income" or the expression "tax *based* on entire net income" or the expression "tax *on* net income" is employed.

In fact, more than once in the course of the extended verbiage of this statute, such significant phrases as the following are employed:

> "the tax * * * imposed *upon* the entire net income" (§214).
>
> "* * * taxed *upon* the entire net income" (§214, subd. 8).
>
> "* * * franchise tax *on net income* as provided in Section two hundred and nine of this article * * * " (§214, subd. 10).
>
> "* * * shall be *taxed upon* such combined entire net income * * *" (§214-a).

> "* * * tax *on* entire net income as hereinbefore provided" (§214-a).

The New York Court of Appeals, in an opinion by Judge Cardozo, in *People ex rel. Alpha Portland Cement Co.* v. *Knapp*, 230 N. Y. 48, (1920) said of this very tax (pp. 57, 62):

> "* * * the tax imposed upon this franchise must be held in practical operation to be a *tax upon the income*. Such, indeed, it would be in form as well as in substance, if the legislature had not stated (sec. 209) that the 'privilege of doing business' was the consideration for the payment. Nothing but that recital stands between the statute and conceded invalidity. How the legislature itself looked upon the substance of the burden is indicated by other provisions of the same and later statutes. The tax is to be in lieu of all other taxes on personal property or capital stock (Tax Law, sec. 219-J). It is to be in lieu of all other taxes upon income (sec. 350, subd. 7). There surely was no intention that all mercantile and manufacturing corporations, foreign and domestic, should in very truth be exempt from taxes upon property so fundamental in importance as capital and the fruits of capital. The reason for the apparent exemption was that, under the form of a tax upon the franchise, the property of such corporations had already been subjected to its share of public burdens. I think, therefore, that in substance, though not in form, in tendency, though not in name, this tax is equivalent to a tax upon relator's income. * * * In form, the tax is one upon the value of a privilege, and income is nothing but the measure. *In substance*, as we have seen, it is the same as if *imposed directly upon* income." (Italics ours).

In *Macallen Co.* v. *Massachusetts*, 279 U. S. 620, at page 629, this Court said:

> "* * * the state cannot tax the instrumentalities or bonds of the United States, or, what is the

> same thing, the income derived therefrom, *directly or indirectly* * * *". (Italics ours).

This Court said in *Weston* v. *Charleston*, 2 Pet. 449, 468, quoted in *Farmers, etc. Bank* v. *Minnesota*, 232 U. S. 516, and in the *Macallen* case:

> "The right to tax the contract (a federal instrumentality) *to any extent*, when made, must operate upon the power to borrow before it is exercised, and have a *sensible influence* on the contract. The extent of this influence depends on the will of a distinct government. *To any extent, however inconsiderable*, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely." (Italics ours).

And, as we shall discuss in a later point (III, infra) this Court, in the *Macallen* case, referring to the Massachusetts corporation excise tax, which may more properly be characterized "excise tax" than may the New York tax here involved, said (pp. 626, 634):

> "And this court must determine for itself by independent inquiry whether the tax here is * * * an excise tax on the privilege of doing business, or, under the guise of that designation, is in substance and reality a tax on the income derived from tax-exempt securities."

(p. 634):

> "* * * the amended act *in substance and effect* imposes a tax upon federal bonds and securities."

In the brief filed in behalf of the New York State Tax Commission, as *amicus curiae*, in the *Macallen* case, the State of New York said, by its counsel (p. 2):

> "The taxing systems of the State of New York and the Commonwealth of Massachusetts are so

> nearly identical in the particulars wherein they are affected by this suit that whatever decision is reached by this court will doubtless apply with like force to the State of New York.
>
> " * * * (p. 4) the New York law parallels the Massachusetts law in that the primary basis for the imposition of the tax is the entire net income as returned to the United States. * * * (p. 4) The tax is *UPON net income* * * * (p. 5) the New York legislature was actuated by the same motives as was the legislature of Massachusetts when it enacted St. 1925, c. 343, amending G. L. c. 63." (Italics ours.)

In *People ex rel Bass, Ratcliff, etc.* v. *Tax Commission*, 232 N. Y. 42, aff'd 266 U. S. 271, the New York Court of Appeals said, p. 46:

> "The tax is denominated a franchise tax and although we have said *in another connection* (*People ex rel. Alpha P. C. Co.* v. *Knapp, supra*, p. 57) that 'the tax imposed upon this franchise must be held in practical operation to be a tax upon the income * * * . This tax is equivalent to a tax upon relator's income', it is primarily a tax levied for the privilege of doing business in the state." (Italics ours).

And this Court (266 U. S. at p. 280) said:

> "We see no reason to doubt the accuracy of the statement made by the Court of Appeals in the present case that the franchise tax imposed by the statute is 'primarily a tax levied *for* the privilege of doing business in the State.' It is not a *direct* tax upon the allocated income of the corporation * * *." (Italics ours).

But it will be noted that neither this Court nor the New York Court of Appeals declared the tax to be, even "primarily", a tax *on* the privilege, or in the slightest degree dissented from Judge Cardozo's description of it (230 N. Y. pp. 57, 62, *supra*) as "in practical operation * * * a tax upon the income."

In the *Bass, Ratcliff* case the Court was not considering income which was exempt, *per se*, from state taxation. It was considering income from interstate commerce, whose immunity from state taxation is not absolute, but merely one of degree (See *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505, discussed in III, *infra*).

In 1925, several years after the decision in the *Bass, Ratcliff* case, a New York court in *De La Vergne Co.* v. *Tax Commission*, 211 App. Div. 227, affirmed by the Court of Appeals (241 N. Y. 517) said, concerning this tax (p. 231):

> "* * * It was the net income received by the corporation during that year which was made the basis of the tax. Therefore, if we regard the tax as being essentially a tax upon net income it was a tax upon income accruing to the United States and consequently invalid as a tax upon Federal property. The same result follows if we regard it as a tax upon the privilege of doing business or exercising a franchise."

As we have seen above, the New York statute itself, in describing the tax, repeatedly refers to it not merely as a "tax *based on* net income" but actually as a "tax *upon* entire net income", the latter expression being employed in several different places in the statute.

Even the introductory phrase, which is employed just once (§209), recites that the tax shall be paid "*for* the privilege * * *", rather than that the tax is "*on* the privilege". So much for the statute itself.

As for the judicial characterization of the tax, we have seen that Judge Cardozo's description of it as in substance and practical operation a "tax on income" has never been disapproved, and that the farthest that either the Court of Appeals or this Court has gone in the direction of calling the levy a privilege tax is to say that it is not a *direct* tax on income, and that primarily the tax is paid "*for* the privilege".

Even the Attorney-General of New York has, as we have seen (p. 18, *supra*), referred to the tax as a tax *upon* net income.

From all of the foregoing we distill the following summary of the nature of the tax in question, viz.: that, whether or not the tax is a *direct* tax on income, and primarily a tax paid *for* the privilege of exercising the corporate franchise, it is nevertheless in substance and effect and practical operation a tax *on income.*

The decisions of this Court with respect to the Wisconsin and Massachusetts corporation excise taxes show that there is no inconsistency in holding (as the New York courts have done) that a given tax may be *for a privilege* and still, in *substance and effect,* be a *tax on income.*

In *Northwestern Ins. Co.* v. *Wisconsin,* 247 U. S. 132 (1917) this Court said (p. 137):

> "The tax in question is * * * one for the privilege of doing * * * business."

Yet in *Northwestern Ins. Co.* v. *Wisconsin,* 275 U. S. 136 (1927) this Court said (p. 139):

> "* * * this Court has interpreted the statute and pointed out its real nature. *Northwestern Mutual Life Ins. Co.* v. *State of Wisconsin,* 247 U. S. 132, 137. Speaking there of this same statute we did declare: 'The tax in question is, therefore, not only one for the privilege of doing life insurance business within the State, but is in effect a commutation tax levied by the State in place of all other taxation upon the personal property of the company in the State of Wisconsin'. But no question was then raised concerning taxation of income derived from United States bonds. The point now presented was not involved. * * * This amounts, we think, to an imposition on the bonds themselves."

Likewise, with respect to the Massachusetts tax, the statute itself proclaims the tax to be an "excise" (G. L., c. 63, Sec. 32), and both the Massachusetts Courts and this Court have described it as

> "• • • not taxes *on* property or net income, but taxes *measured by* property and net income."
>
> *Alpha Portland Cement Co.* v. *Massachusetts*, 268 U. S. 203, 216
>
> *Baltic Mining Co.* v. *Massachusetts*, 231 U. S. 68, 84, and 207 Mass. 381
>
> *S. S. White Dental Co.* v. *Commonwealth*, 212 Mass. 35.

And even the amendment which this Court in the *Macallen* case declared unconstitutional was described by the highest State Court as follows:

> "It is an excise with respect to the carrying on or doing of business by the corporation, measured by property and net income. It is not a tax on property and net income" (264 Mass. 396, 400).

Yet this Court, in the *Macallen* case (*supra*) said (p. 634):

> "• • • *in substance and effect* (it) imposes a tax upon federal bonds and securities." (Italics ours.)

Similarly, the Supreme Court of Washington, in the recent case of *Aberdeen Savings and Loan Ass'n* v. *Tax Commission*, 57 Wash. 255; 289 Pac. 536 (discussed in III, *infra*), decided June 12, 1930, declared a tax "for the privilege of exercising corporate franchise" to be an attempt to levy a *tax on income from federal securities.*

And the Tennessee Supreme Court in June 1930 in the case of *Quicksafe Mfg. Corp.* v. *Graham*, (Tenn.) 29 S. W. (2d) 253 (discussed in III, *infra*) held that a

similar corporation excise tax, in so far as based on *income from patents,* was such as to

> "* * * *amount* to a tax upon the patent right itself" (quoting *Long* v. *Rockwood,* 277 U. S. 145).

III.

Under the authority of the Macallen case, Article 9-A of the New York tax law is unconstitutional in so far as the tax thereunder is based on income from federal instrumentalities.

In three cases—the only cases, so far as we have been able to find, in which the *Macallen* decision has been interpreted—it has been interpreted as holding that a state tax, though in form an excise tax, is unconstitutional in so far as it taxes, directly or indirectly, income from federal instrumentalities.

The Supreme Court of the State of Washington, following the *Macallen* case, has held that the excise tax law of that State (C. 151, Laws of 1929) is unconstitutional in so far as it includes in the measure of the tax income from tax exempt securities. Answering the contention that the tax is an excise tax and not a tax on income, the Court said:

> "Respondents contend that the tax provided for by the statute is technically an excise for the privilege of doing business as a corporation, or what is generally known as a corporate franchise tax. For the purposes of this opinion, we assume that a tax by way of an excise to be collected by the state for the exercise of corporate privileges would be valid. The act itself in section 3 and 4 contains a recital that the tax is to be paid by each corporation liable thereto 'for the privilege of exercising its corporate franchise within this

state.' Such a legislative declaration is to be carefully considered by the courts and due weight given thereto. Courts should, however, in construing an act containing such a declaration, consider the true operation and effect of the law which must be dealt with on the basis of the practical results which follow its operation, and not alone by legislative declarations contained therein.

In this connection the following opinions of the Supreme Court of the United States are pertinent: Craig *v.* Missouri, 4 Pet. 410, 7 L. Ed. 903; Mugler *v.* Kansas, 123 U. S. 623, 8 S. Ct. 273, 31 L. Ed. 205; Louisville Gas & Electric Co. *v.* Coleman, 277 U. S. 32, 48 S. Ct. 423, 72 L. Ed. 770; St. Louis Cotton Compress Co. *v.* Arkansas, 260 U. S. 346, 43 S. Ct. 125, 67 L. Ed. 297; Postal Tel.-Cable Co. *v.* Taylor, 192 U. S. 64, 24 S. Ct. 208, 48 L. Ed. 342; Macallen Co. *v.* Massachusetts, 279 U. S. 620, 49 S. Ct. 432, 73 L. Ed. 874."

"Appellants rely on the opinion of the Supreme Court of the United States in the case of Macallen Co. *v.* Massachusetts, 279 U. S. 620, 49 S. Ct. 432, 73 L. Ed. 874, in which an opinion of the Supreme Judicial Court of Massachusetts, holding constitutional a law of that state providing for the payment by Massachusetts business corporations of an annual payment by way of an excise, was reversed and the law held unconstitutional. The statute of Massachusetts which was attacked required, among other things, the payment of 'an amount equal to two and one-half per cent. of that part of its net income, as defined in this chapter, which is derived from business carried on within the commonwealth'. St. Mass. 1923, c. 424, Sec. 1. The law had at one time exempted from the net income upon which the tax should be computed interest upon bonds, notes, and certificates of indebtedness of the United States, but by amendment this exemption was deleted, and no deduction of such interest in computing the net income was provided for."

"The court assumes, as a controlling principle, that the state cannot tax the instrumentalities or

bonds of the United States, while on the other hand the state is at liberty to tax corporations with respect to the doing of business."

Aberdeen Savings & Loan Assn. v. *Chase*, 57 Wash. 255 at pp. 265, 267 and 268, 289 Pac. 536 at pp. 542 and 543.

Similarly, the Supreme Court of Tennessee, since the *Macallen* decision, has held that the corporate excise tax of that state (c. 21, Acts of 1923) may not be imposed upon *royalties from patents:*

"The defendants appealed, insisting that complainant is subject to the excise tax imposed by chapter 21, Acts 1923. The tax levied by this act is a privilege tax upon domestic and foreign corporations organized for profit and carrying on business in this state. The annual tax is measured by a sum equal to 3 per cent. of the net earnings for each preceding fiscal year, arising from business done wholly within the state. * * *

"The complainant derived no profit from the manufacture and sale of the patented article which was manufactured by the licensee. Its income was derived altogether from the royalties on its patent right. The state could not levy a tax upon the value of the patent right, and where the state attempts to tax income inquiry is allowed to the sources from which the income is derived, and the same considerations that would invalidate a tax upon the source would also invalidate a tax upon the income."

Quicksafe Mfg. Corp. v. *Graham*, (Tenn.) 29 S. W. (2d) 253.

In the matter of the appeal of *Vortox Mfg. Co.*, before the State Board of Equalization of the State of California, the Board was asked to find that the corporate franchise tax act of California (Chap. 13, Stat. 1929)

was unconstitutional in so far as it included in the tax base income from patent royalties. The Board said:

> "The appeal is based upon the proposition that inclusion of patent royalties in the tax base is, in effect, taxation of income from a federal instrumentality.
>
> "In support of this view the appellant cites two recent decisions of the United States Supreme Court. One of these, Long *v.* Rockwood, 277 U. S. 142, holds that a state may not tax directly royalties from patents. The other, Macallen *v.* Massachusetts, 279 U. S. 620, holds that, under the guise of an excise tax measured by net income, a state may not tax income from exempt sources, such as federal and state bonds, thereby accomplishing by indirection what it is forbidden to do directly."
>
> Re *Vortox Mfg. Co.;* Prentice-Hall State Corporation Tax Service, Vol. 1, sec. 11,045, p. 11,123; U. S. Daily, August 13, 1930, p. 1853.

The Board indicated clearly that it considered the act unconstitutional, but, as a non-judicial body, declined to make a decision to that effect, saying:

> "The power to declare a law unconstitutional is one of the highest attributes of judicial authority. Although we sit in these matters as a quasi-judicial body, and must decide questions of law as well as of fact, we should not lose sight of the ultimate fact that we are not a Court but merely an administrative Board. The right of a ministerial officer to question the constitutionality of a statute is generally denied."

The appellees will doubtless contend in this Court, as they did in the Court below (1) that the decision of this Court in the *Macallen* case rested solely upon evidence of intent of the Massachusetts legislature to reach exempt income; (2) that no such intent was manifested by the New York legislature; and (3) that therefore the

decision in the *Macallen* case does not apply to the New York tax statute herein questioned.

The contention that the decision of this Court in the *Macallen* case is limited to cases where legislative intent to tax exempt income can be shown is inconsistent with what was said by the State of New York in its brief filed, as *amicus curiae*, on the petition for re-hearing in the *Macallen* case, through its Attorney General:

> "It may be that the Court intended to limit its decision to those cases where the State legislature has deliberately set out to reach non-taxable income under the guise of an excise tax. We doubt that this can be a correct interpretation of the opinion, however, for under it, as so interpreted, there would exist a situation where certain states would be lawfully including income from tax-exempt securities in the measure of the tax while those states which had offended by specifically including such income would never thereafter be able to include it."

The same argument, that legislative intent was the controlling circumstance in the *Macallen* case, was made to the Supreme Court of the State of Washington in the *Aberdeen* case (*supra*). That Court rejected the argument in the following language (p. 269):

> "On behalf of respondents it is argued that the ruling of the *Macallen* Case was based wholly on the fact that the court felt constrained to hold that the real object and purpose of the Massachusetts act was to impose a tax upon governmental tax-exempt securities. It is true, as above stated, that the act as originally passed provided that interest upon such securities should be deducted in determining the net income upon which the tax should be computed, and that a special tax commission appointed to consider the tax situation in Massachusetts made a report in which it recommended that the law be amended by disallowing

this exemption, and that the Legislature thereupon passed an amendatory act following the suggestion of the commission, thereby distinctly indicating a change of policy on the part of the state. In its opinion the Supreme Court of the United States refers to this action on the part of the Legislature, as indicating an express purpose to subject governmental tax-exempt securities to the burden of the tax, and states 'that the amended act in substance and effect imposed a tax upon federal bonds and securities'. It is, of course, true that these remarks of the Supreme Court were clearly warranted by the facts before it, but we are unable to see that this makes any difference in the principle involved. The act of the Legislature of this state now under consideration was enacted after the passage of the amended act by the Massachusetts Legislature, and after that act had been held constitutional by the Supreme Judicial Court of that state. No act of any similar nature existed in this state prior to the passage of the statute of 1929, and we cannot imagine that it could be held that the amended act of Massachusetts was unconstitutional, in so far as it affected federal tax-exempt securities, and that the act of this state could be held good in that particular, simply because prior to the enactment of the 1929 statute no law of similar purport had existed in this jurisdiction. It is true that the primary purpose of the Legislature of Massachusetts in passing the amendatory act may have been to procure for the state as part of its revenue a proportion of the interest paid to Massachusetts corporations by the United States on governmental securities, while nothing in the record now before us indicates that such was the *primary* purpose of the Legislature of this state in enacting the 1929 law. But this again makes no difference in the principle involved, which is identical in both instances. It is, of course, true, as argued on behalf of respondents, that the Supreme Court of the United States did not hold that a state cannot tax the corporate privilege and measure the tax

by net income; the court expressly saying that 'the state is at liberty to tax a corporation with respect to the doing of its business'. The court continues, however, by saying that 'the state cannot tax the income of the corporation derived from nontaxable securities'.

"The Legislature, in enacting such a statute as that now before us, must be held to have primarily intended all the major consequences of the act, and we are clearly of the opinion that, under the ruling of the Supreme Court in the case of Macallen Co. *v.* Massachusetts, supra, the law of 1929, unlawfully attempts to levy a tax upon governmental securities, which under the law of the United States the state has no right or power to tax."

The State Board of Equalization of the State of California in considering the question of intent said:

"Each of these cases involves taxing statutes of the Commonwealth of Massachusetts, and the Franchise Tax Commissioner seeks to differentiate the 'history' of the effort to reach tax exempt income by 'excise' taxation there and in California. We do not find the 'differences' urged particularly convincing. It is true that the taxation of income from exempt sources was sought to be accomplished in Massachusetts through amendment of an existing excise statute rather than through adoption of an entirely new law as in California. But to make this a vital point of difference would be virtually to hold that Massachusetts may not take in two bites what California may have in one."

Re Vortox Mfg. Co., (supra).

Even assuming that the intent of the legislature was a pertinent factor in the *Macallen* case, as to federal instrumentalities, the New York statute is in no better case in that respect than the Massachusetts statute.

In *People ex rel. Standard Oil Co.* v. *Law*, 237 N. Y. 142, the New York Court of Appeals held, as a matter solely of statutory construction, that "net income" as defined in Section 208, subdivision 3, did *not* include income from state and municipal bonds nor from *certain* federal bonds (though it *did* include income from certain other federal bonds; see page 147).

Thereafter, by chapter 329 of the laws of 1924 the New York legislature amended Section 208, subdivision 3, of the Tax Law so as to nullify the decision in *Peo. ex rel., Standard Oil Co.* v. *Law,* and *designedly reach*, in the language of the amended statute, "*ALL interest received from federal, state, municipal or other bonds.*"

By chapter 479 of the laws of 1927 the law was again amended, in Section 209, so as to reach "*income from any source.*"

New York thus did exactly what the Supreme Court in the Macallen case condemned Massachusetts for doing.

The New York State Tax Commission in its brief filed *amicus curiae* in the *Macallen* case insisted that the New York tax and the Massachusetts tax are identical in the particulars which were material to the *Macallen* decision (see quotation at pages 17 and 18, *supra*), and that "the New York legislature was actuated by the same motives as was the legislature of Massachusetts * * *."

The Court below (R., 58) said:

> "We think it now beside the point that the New York law as amended may, in so far as interest on federal bonds is concerned, be the result of motives not unlike those responsible for the Massachusetts law held invalid in the Macallen case. That question is not before us. Copyright income was not excluded from gross income in the exception in the federal law referred to in Peo. ex rel. Standard Oil Co. *v.* Law et al., supra".
>
> *Educational Films Co. of America* v. *Ward*, 41 Fed. (2d) 395, at p. 397.

But the fact that copyright and patent income was not excluded from gross income prior to the amendment following the *Standard Oil* case does not distinguish those federal instrumentalities from federal bonds; for *income from certain federal bonds was not excluded,* even prior to the amendment of 1924 (see *Peo. ex rel. Standard Oil Co.* v. *Law, supra,* at p. 147, referring to N. Y. Laws 1919, c. 726, §209 and §§213(a) and 213(b) of the federal Revenue Act of 1918).

Thus, any distinction between income from copyrights and income from federal bonds which is based on the New York legislative history, would logically require a distinction between interest on certain federal bonds and interest on certain other federal bonds.

The rather striking result of such a distinction would be that interest on some federal bonds would be constitutionally exempt from the New York corporation tax, while interest on other federal bonds would be subject to that tax.

The New York tax cannot, we submit, be an excise tax as to income from some federal instrumentalities and an income tax as to others.

A further attempt to distinguish the New York tax from the Massachusetts tax passed on in the *Macallen* case is that the income upon which the tax is based under the New York law is that for the *preceding* calendar or fiscal year. Under the New York law the tax is payable each year in advance for the year beginning November 1st. Thus, in paying its tax in New York a corporation is paying a tax for the succeeding year based on its income for the preceding year.

It might well be argued that this elaborate and artificial separation of *income year* from *tax year* indicates that the New York legislature in framing the tax law was deliberately trying to conceal the fact that it intended to tax *all* income—including exempt income.

Suffice it to say that, under the tax laws held unconstitutional in Washington and Tennessee the income upon which the tax is based is, as under the New York law, that of the *preceding year,* and the Supreme Court of each of those States, nevertheless, held the tax unconstitutional in so far as it reached exempt income. So, too, in California, the income upon which the tax is based is that of the preceding year and yet the State Board of Equalization expressed the opinion that the tax is unconstitutional.

There are at least four considerations not applicable to the Massachusetts tax indicating that the New York tax is a tax on income and not an excise or franchise tax:

(1) The New York law itself uses various expressions indicating that it is essentially a tax on income (See II, *supra*). The Massachusetts statute (G. L. Mass., c. 63, sec. 32 as amended by stat. 1923, c. 424, sec. 1) provides:

> " * * * every domestic corporation shall pay * * * *an excise* equal to * * * ". (Italics ours).

The Massachusetts statute by its own terms has greater claim to the characterization of an excise or franchise tax than the New York statute. And yet this Court held the Massachusetts statute in effect a tax on income so far as tax-exempt securities are concerned.

Macallen v. *Massachusetts,* 279 U. S. 620.

(2) In Massachusetts the highest court in that state held that the tax was an excise and not an income tax. In New York the Court of Appeals has held the tax to be "in practical operation a tax on income".

People ex rel. Alpha Port. Cement Co. v. *Knapp,* 230 N. Y. 48, 57.

See also

De La Vergne v. *State Tax Commission,* 211 App. Div. 227, aff'd 241 N. Y. 517.

And the New York Court of Appeals has at no time held that the tax is *not* a tax on *income*. This Court in *Bass* v. *Ratcliff* (*supra*) held that the tax was not a *direct* tax on *income*, but did not hold that it was not an *indirect* tax on *income*.

(3) The Massachusetts tax has that further attribute of being an "excise" in the strictest sense of the word, viz.: that it is collectible only when the corporation has in fact been engaged in doing business during the taxable year.

> *Massachusetts Gen. Laws* (1921) c. 63, §32.
> *Macallen* v. *Mass.* (*supra*), dissenting opinion (p. 635) citing
> *Fore River etc. Corp.* v. *Commonwealth*, 248 Mass. 137, 140.
> *Attorney General* v. *Boston etc. R. R. Co.*, 233 Mass. 460.

By contrast, the New York tax is levied upon every domestic business corporation, regardless of whether or not the privilege is availed of.

> *Article 9A, New York Tax Law, Sec. 209.*
> *People* v. *Jersawit*, 263 U. S. 493.

The New York tax on domestic business corporations is more nearly a burden on the corporation itself (as distinguished from a burden on what it does) than is the Massachusetts tax; and while the New York tax is labeled as being "*for* the privilege of exercising its franchise" the quoted words are in practical operation redundant, since the tax reaches *every* domestic business corporation, by reason of its mere existence as such.

In *People ex rel. Alpha Portland Cement Co.* v. *Knapp* (*supra*), the New York Court of Appeals held the New

York law to be unconstitutional in so far as the base includes income of a *foreign* corporation from federal bonds or other intangibles not included in the segregation formula saying (p. 62):

> "* * * the domestic corporation pays for the mere exercise of its franchise in a corporate capacity. In form, the tax is one upon the value of a privilege and income is nothing but the measure. In substance, as we have seen, it is the same as imposed directly upon income."

The Massachusetts tax, on the other hand, may be described exactly in the language in which the 1909 federal excise tax measured by corporate net income, was described in *Flint* v. *Stone-Tracy Co.* (*supra*):

> "* * * The tax is imposed not upon the franchises of the corporation, irrespective of their use in business (p. 145) * * * As was said in the Thomas case, 192 U. S. 363, the requirement to pay such tax involves the *exercise* of privileges and the element of *absolute and unavoidable demand* is lacking. *If business is not done* in the manner described in the statute, *no tax is payable* (p. 151) * * * The tax in this case, as we have construed the statute, is imposed upon the *exercise* of the privilege of doing business in a corporate capacity" (p. 155). (italics ours)

(4) Under the Massachusetts statute (G. L. c. 63, Sec. 32, as amended by St. 1923, c. 424, Sec. 1) the tax consists of two parts, viz.: (1) an amount equal to Five Dollars per thousand upon the value of the corporate excess, and (2) an amount equal to two and one-half per cent of that part of the net income which is derived from business carried on within the state.

In Massachusetts the tax is thus measured, only *in part*, by net income.

In New York the corporate net income (where that is the basis at all) constitutes the *sole* basis of the tax.

IV.

The decisions in Flint v. Stone-Tracy Co., 220 U. S. 107, and earlier cases are inapplicable to the New York statute here involved.

This Court said in the *Macallen* case (279 U. S. 620, at 628):

> "The Court below predicates its decision upon a series of decisions of which *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, is the *extreme example*, holding that a tax lawfully imposed upon the exercise of corporate privileges within the taxing power may be measured by income from the property of the corporation although a part of such income is derived from nontaxable property. See also *Home Ins. Co.* v. *New York*, 134 U. S. 594; *Society for Savings* v. *Coite*, 6 Wall. 594; *Provident Institution* v. *Massachusetts*, 6 Wall. 611" (italics ours).

It will be noted that while the Court below regards the *Macallen* decision as *marking the limit* of what franchise taxes are to be condemned as reaching exempt income, (with the *Flint* case, apparently, as the norm), this Court refers (*supra*) to the *Flint* case as the *extreme example* of those which permit exempt income to be employed as a tax measure.

But the *Flint* case can readily be distinguished from the case at bar, even if it be regarded, after twenty years, as a modern authority.

The statute in the *Flint* case was, and was declared to be (pp. 144, 145):

> "* * * a special *excise* tax".

It was not, like the New York tax, one variously denominated "a tax based on income" or "a tax *upon* entire net income" payable *for* the privilege of exercising a

franchise and declared by the Courts to be "in practical operation a *tax on income.*"

Neither the statutory language nor any court decision admitted of any characterization of the tax in the *Flint* case as a tax *on* income, even an *indirect* tax on income.

The decision in the *Flint* case was based essentially on the fact that the tax there under consideration was an *excise*, which the court defined in the following language (p. 151):

> "The tax under consideration, as we have construed the statute, may be described as an *excise* * * * As was said in the *Thomas* case, 192 U. S. 363, the requirement to pay such tax involves the *exercise* of privileges, and the element of absolute and unavoidable demand is lacking. *If business is not done* in the manner described in the statute, *no tax is payable*" (italics ours).

As we have shown above (III, pp. 32 and 33, *supra*), the New York tax fails to meet the specifications of the definition of an excise as set forth in the *Flint* case, in that a domestic corporation is required to pay the tax regardless of whether or not it exercises the privilege, so that the tax burden is "absolute and unavoidable". That feature alone would seem completely to distinguish the case at bar from the *Flint* case.

Furthermore, unless the tax in the *Flint* case had been, of a certainty, an excise, and by no possibility a tax on income even "in substance and effect", it would have been *void in toto*—for at that time (1909) the Sixteenth Amendment had not been adopted.

On the other hand, there was no constitutional restraint on the New York Legislature in enacting a statute imposing a tax "essentially" on income, or even avowedly *on* income, except in so far as it assumed to include in its base income from exempt sources.

In the *Macallen* case (*supra*) this Court said (pp. 629, 631):

> "* * * the controlling principle, constantly to be borne in mind, is that the state cannot tax the instrumentalities or bonds of the United States, or, what is the same thing, the income derived therefrom, directly or indirectly; that is to say, it cannot tax *them* in any form * * * A liberal application of the foregoing principles, which find confirmation *especially in the later decisions of this court*, is essential to the preservation of the constitutional limitations imposed upon the taxing power of the states" (last italics ours).

Among the "later decisions of this Court" preserving, and we think expanding, the immunity from state taxation of federal instrumentalities, are the following:

In 1922, this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505, held unconstitutional a tax on the *net* income of the lessee of Indian lands (a federal instrumentality) and made a distinction (p. 505) between the relative immunity from state taxation of income from interstate commerce and the absolute immunity of income from instrumentalities of the United States.

In 1923, this Court in *Clallam County* v. *United States*, 263 U. S. 341, held unconstitutional a state tax on property owned by United States Spruce Production Corporation, a federal instrumentality.

In 1926, this Court in *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, held unconstitutional a property tax on coal mined from Indian lands.

In 1927, this Court in *Northwestern Insurance Co.* v. *Wisconsin*, 275 U. S. 136, held unconstitutional a state license fee measured by gross income including interest from federal bonds saying (p. 141) that the tax *amounted* to an imposition upon the bonds themselves, finding no inconsistency in its previous statement (247 U. S. 132, 137) that the same tax was a *privilege* tax.

In 1927, this Court in *Miller* v. *Milwaukee*, 272 U. S. 713, held unconstitutional a state tax on dividends in so far as they represented interest from federal bonds.

In 1928, this Court in *Panhandle Oil Co.* v. *Mississippi*, 277 U. S. 218, held a tax on the *privilege* of selling gasoline (though the *subject* was not immune), to be unconstitutional in so far as the tax was applied to and *measured* by the number of gallons sold to the United States Coast Guard (a federal instrumentality) saying at p. 222:

> "To use the number of gallons sold the United States as a *measure* of the privilege tax is in substance and in legal effect to tax the sale." (Italics ours).

In 1928, this Court in *Long* v. *Rockwood*, 277 U. S. 142, held unconstitutional a tax on net income in so far as it included royalties from patents, another federal instrumentality.

In 1928, in *National Insurance Co.* v. *U. S.*, 277 U. S. 508, this Court held unconstitutional a federal taxing statute in so far as it granted a statutory exemption to insurance companies merely as an *alternative*, rather than as an *addition* to, the exemption of their governmental bonds.

And, as we have seen, in 1929, this Court in *Macallen* v. *Massachusetts*, 279 U. S. 620, held unconstitutional an excise tax in so far as measured by net income, including interest on tax-exempt bonds, which it found to be in substance and effect a tax on the income itself.

In 1930, this Court, in *State ex rel. Missouri Ins. Co.* v. *Gehner*, 281 U. S. 313, held unconstitutional a state tax in so far as the amount of certain statutory deductions was abated in the proportion that the federal securities of the tax payer bore to its total assets.

In the *Macallen* case the New York Tax Commission (appellees in the present case) filed a brief, as *amicus curiae*, insisting that whatever decision should be reached would "doubtless apply with like force to the State of New York" (p. 25 *supra*).

The States of Washington and California were also among those states which, as *amici curiae*, filed briefs in support of the petition for re-hearing in the *Macallen* case.

It is therefore of peculiar significance that, since the *Macallen* decision, the highest court of the State of Washington has held, concerning a privilege tax which is clearly more deserving of that characterization than the New York tax, that it is unconstitutional to the extent that it is measured by net income including income from federal bonds.

Aberdeen Savings & Loan Assn. v. *Chase, supra.*

And, also since the *Macallen* decision, the state of California, through its State Board of Equalization (*Re Vortox Mfg. Co., supra)* has likewise indicated strongly that the California franchise tax is to the same extent unconstitutional, and refrained from a definite ruling to that effect only because, as a non-judicial body, it lacked the power to overrule a statute of the state.

The highest court of the state of Tennessee, also since the *Macallen* decision, has reached the same conclusion with respect to an excise tax measured by net income from *patents.*

Quicksafe Mfg. Corp. v. *Graham (supra).*

Thus, in the only decisions of state courts or administrative bodies (except in New York), which we have been able to find, interpreting the *Macallen* decision, the necessary implication has been that the *Macallen* decision, in effect, overrules the decision in *Flint* v. *Stone-Tracy Co.*

But, we respectfully submit, it is not necessary for this appellant to rely upon the proposition that the *Macallen* decision definitely overruled the decision in *Flint* v. *Stone-Tracy.* As we have pointed out (p. 32, *supra)* the New York Tax Law is clearly to be distin-

guished from the federal excise tax which is the subject of the *Flint* decision.

It may also be pertinent to point out that when this Court, twenty years ago, decided the *Flint* case, excise taxes measured by corporate net income were virtually unknown to the states. Since that time, state after state has seen fit to base its corporation tax upon net income in lieu of all other taxes (except on real estate) with no apparent reason why they should declare such taxes, in form, to be excise taxes, rather than income taxes (as the present federal income tax is now declared to be) unless it be their purpose to include otherwise exempt income in the basis of the tax.

The federal government, by its candor in labeling its corporation tax an *income* tax, surrenders all claim to taxing corporate income from *state* instrumentalities. Some of the states, by a like candor in labeling taxes based on corporate net income, have admitted that corporate income from *federal* instrumentalities (like individual income therefrom) is beyond their power to tax. Should others of the states, by adopting a less candid label, be permitted *in effect* to tax income from federal instrumentalities?

The *Flint* case deals with the question of the immunity of income from *state instrumentalities* from federal taxation, rather than with the immunity of *federal instrumentalities* from state taxation. That this of itself might be the basis of a possible distinction is indicated by the following language of Chief Justice Marshall in *McCulloch* v. *Maryland*, 4 Wheat, 316, 435:

> "The difference is that which always exists, and always must exist, between the action of the whole on a part, and the action of a part on the whole."

The earlier cases, so much relied upon to defend state encroachments upon the federal domain, viz.: *Home Ins.*

Co. v. *New York* (1889) 134 U. S. 594; *Society for Savings* v. *Coite,* 6 Wall. 594; and *Provident Institution* v. *Massachusetts,* 6 Wall. 611, are clearly distinguishable from a case where a tax is based on net income including income from a federal instrumentality.

In both the *Coite* case and the *Provident* case, the tax is measured by *deposits,* so that the federal instrumentalities involved (federal bonds) were not *included* in the measure of the tax. Deposits are liabilities, viz.: debts owing by a bank to its depositors. If the state tax in those two cases had been measured by assets (including federal bonds) instead of by liabilities (deposits) the ruling of this Court would no doubt have been different.

In the *Home Insurance* case the measure of the tax was the *capital stock* of the corporation, which might or might not have a direct relationship to the amount of its federal bonds.

In short, in not one of the three cases last above cited was there the objectionable relationship between the exempt federal instrumentality and the measure of the tax, viz.: that the former was *included* in the latter.

But in every one of the cases which we have cited in support of appellant's contention, the exempt federal instrumentality was *included* in the measure of the tax, if not actually in the very subject of the tax. In every instance net income was either the subject or the measure of the tax, and in every instance the exempt federal instrumentality was definitely included in the net income, so that an increase in the amount of the former would be followed by an identical increase in the amount of the latter and by an exactly proportional increase in the amount of the tax based on the latter.

But if a bank were suddenly presented, on the day before the "tax day", with a $10,000 federal bond, or a patent worth $10,000, the gift would not increase by even one cent the amount of its deposits, or the amount of the tax measured thereby. Capital stock, which was used

as a measure in the *Home Insurance* case, would not *necessarily* be increased by a sudden increase in the amount of federal instrumentalities owned by the taxpayer, or the income therefrom. There was no direct or necessary relationship between the measure of those taxes and the extent or amount of the federal instrumentalities.

But in all cases, like the case at bar, where the tax is either measured by or based on the net income, every dollar of added income from federal instrumentalities automatically and inevitably results in the addition of one dollar to the measure of the tax, and in the addition of an exactly proportional amount to the tax to be paid (in this case four and one-half cents).

V.

The fact that the basis of the tax is net income rather than gross income does not justify the inclusion of income from federal instrumentalities.

Where immunity of income from *federal instrumentalities* is involved no distinction is made between taxes based on *net* income and taxes based on *gross* income.

> *Macallen* v. *Massachusetts*, 279 U. S. 620;
> *Gillespie* v. *Oklahoma*, 257 U. S. 501, 504, 505;
> *Aberdeen Savings and Loan Ass'n* v. *Chase*, 57 Wash. 255; 289 Pac. 536;
> *Quicksafe Mfg. Corp.* v. *Graham*, (Tenn.) 29 S. W. (2d) 253.

The distinction between net and gross income made in *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321, and *Shaffer* v. *Carter*, 252 U. S. 37, does not apply where immunity from taxation from *federal instrumentalities*

is involved. Those cases have to do with an immunity of lesser degree: that of income from interstate commerce.

This Court said in *Gillespie* v. *Oklahoma*, 257 U. S. 501, at 504, 505:

> "The argument for the State is based primarily upon the cases sustaining taxes upon net income that include gains from interstate commerce, *Shaffer* v. *Carter*, 252 U. S. 37, 57; *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321; when 'all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he chooses.' * * * Those decisions appear to us to have been correct. The criterion of interference by the States with interstate commerce is *one of degree*. It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to exist and make laws. *New York, New Haven & Hartford R. R. Co.* v. *New York*, 165 U. S. 628. *Diamond Glue Co.* v. *United States Glue Co.*, 187 U. S. 611, 616. The rule as to *instrumentalities of the United States on the other hand is absolute* in form and at least stricter in substance. *Williams* v. *Talladega*, 226 U. S. 404, 416, 417, 419. *Johnson* v. *Maryland*, 254 U. S. 51, 55." (Italics ours.)

It is true that the *Gillespie* case (*supra*) deals with a *direct* tax on net income, rather than with an excise tax based on net income, but in each of the other three recent cases cited above (the *Macallen* case, the *Aberdeen* case and the *Quicksafe* case) a corporate excise tax based on *net* income was held invalid in so far as it was based on income from federal instrumentalities.

Northwestern Ins. Co. v. *Wisconsin*, 275 U. S. 136, declared unconstitutional a license fee based on gross income to the extent that the income included interest on federal bonds, and made a distinction (at page 140) between net receipts and gross returns as a permissible measure of such a tax, citing two cases where income

from federal instrumentalities was *not involved*. But in view of the cases above cited the distinction, which was *obiter dictum* in the *Northwestern* case, would seem to be unnecessary, at least so far as *income from federal instrumentalities* is concerned.

VI.

Income from royalties on copyrights owned by plaintiff, including income from those registered in the names of others, as well as income from those registered in plaintiff's own name, is equally entitled to exemption from the state tax.

This question is not material here in determining whether the decree appealed from should be reversed or affirmed, because *some* of the copyrights owned by plaintiff were also *registered* in plaintiff's name. The question, at most, affects only the *amount* of the exempt portion of the tax complained of.

The court below has not ruled against appellant on this question. But the question is here discussed because, as we are informed, *appellees* will raise it, and this Court may desire that the lower court be instructed thereon, if the decree be reversed.

The *facts* are not now in issue, the bill having been dismissed on motion, before the joining of issue.

There is no justification for the assertion which appellant made in the Court below and will presumably make in this Court, viz.: that in computing the tax "has deducted income from copyrights which it did not *own*."

Any person may obtain a valid copyright, and become the legal or nominal owner thereof, holding the copyright *in trust* for the actual or equitable owner.

Harms et al. v. *Stern*, 229 Fed. 42 (C. C. A. 2d);

Bisel v. *Laduer*, 1 F. (2d) 436 (C. C. A. 3rd), and cases cited;

Harper v. *Donohue*, 144 Fed. 491, 494, affd. 146 Fed. 1023;

White-Smith Co. v. *Apollo Co.*, 139 Fed. 427 (S. D. N. Y.) affd. 147 Fed. 226, affd. 209 U. S. 1.

The law on that subject is succinctly stated in *Harms et al.* v. *Stern et al., supra*, quoted in *Bisel* v. *Lanner, supra*, as follows:

> "* * * the question of true ownership is one of *fact*, dependent upon the circumstances of the case. *Press Publishing Co.* v. *Falk*, 59 Fed. 324; *Black* v. *Allen Co.*, 42 Fed. 618, 9 L. R. A. 432; *Lawrence* v. *Dana*, Fed. Cas. No. 8136, 9 Cyc. 930." (Italics ours.)

There is no principle of *law* which in any way discredits appellant's flat and positive sworn allegation (R., 5) "that during the fiscal year ending June 30, 1929 *plaintiff* was the owner and proprietor * * * " of the copyrights listed in Schedule A.

Nor are any *facts* advanced which in any way discredit appellant's allegation of ownership, or require the slightest qualification or modification of that allegation.

Nor is there any contradiction of the positive and unqualified allegation by appellant, under oath, that appellant

> "as *such owner* had the exclusive right to project and exhibit said films or production and to license the same for projection or exhibition" (R., 5).

Nor is there the slightest contradiction of appellant's sworn allegation (R., 5, 45) that *appellant*

> "* * * licensed same to sundry exhibitors for projection and exhibition and received substantial sums from said exhibitors as royalties under said copyrights, to wit, the sum of $162,-

> 588.98, which constituted *plaintiff's* income from said copyrights."

Not only are the foregoing allegations of the bill of complaint uncontradicted, but the moving affidavit of appellant's treasurer, while conceding that certain of the copyrights were held in the *name* of other corporations, affiliated with appellant, avers that

> "* * * *all* of said copyrights, however, whether or not standing in the name of plaintiff corporation are and were during the period aforesaid *owned by plaintiff corporation*" (R., 45).

While, in view of the well-settled law, and appellant's positive and unqualified allegations of ownership, it was not required that appellant offer any explanation of its *reasons* for having some of its copyrights registered in the name of other corporations, the reason is made apparent by the undisputed statement in the moving affidavit (R., 45) that the *nominal owners* were

> "* * * corporations handling the production thereof upon plaintiff's order and at plaintiff's expense."

It is undisputed that *plaintiff* "paid the costs of production thereof", and that *plaintiff* had "exclusive control and disposition thereof", and that *plaintiff* was "entitled to *all* the income therefrom except certain agreed commission and percentages."

It is also undisputed (R., 45) that

> "*Plaintiff's* gross income during said period, to the amount of $162,588.98, consisted of royalties received by *plaintiff* from said copyrights under so-called license contracts entered into between *plaintiff* and various exhibitors of motion pictures, whereby *plaintiff*, in consideration of the payment of said royalties, granted unto said ex-

> hibitors the right, for certain specified periods and in certain specified theatres or localities, to project and exhibit said copyrighted motion picture productions under said copyrights." (Italics ours).

Not only was plaintiff the actual owner, which had caused the copyrighted films to be produced at its expense, and was entitled to receive, and did receive, all the income therefrom, but plaintiff was in every instance the party (licensor) which, under the uniform contract, Exhibit "C", granted to the exhibitors the license under the various copyrights to exhibit the films.

> " * * * all of *plaintiff's* said income from said copyrights having during said period been paid to and received by *plaintiff* from licensees under contracts in that form" (R., 45).

Other instances where copyrights have been registered in the *name* of one person, and *actually owned* by another person, are found in the following cases:

> *Mifflin* v. *R. H. White Co.*, 190 U. S. 260, 263;
> *Brady* v. *Reliance Motion Picture Corp.*, 232 Fed. 259, 260;
> *Dam* v. *Kirk LaShelle Co.*, 175 Fed. 902, 905.

In the last-cited case the Circuit Court of Appeals for the Second Circuit quotes with approval *Drone on Copyright*, page 260, in part as follows:

> "A person who is not the author or owner of a work may take out the copyright in his own name, and hold it in trust for the rightful owner."

The various affiliated corporations who registered appellant's copyrights in their names of course did so with appellant's consent.

It is true that in an explanatory statement annexed to appellant's return it stated that the copyrights were

"owned by it *or its affiliated companies*". The word "owned" in that document was used in the sense of legally or nominally owned. The fact, however, that the return set forth that it was appellant which received the royalties under such copyrights and claimed constitutional immunity from taxation thereon, must have prevented defendants from being misled by the quoted expression.

However that may be, there was no possible ambiguity or doubt in the sworn allegations of the *bill of complaint* (R., 5) and moving affidavit (R., 45), and at the invitation of the State Tax Commission a formal hearing has been had before that body since the bill of complaint was filed herein, and *on demurrer* the allegation of ownership stands undisputed.

Such allegation also stands admitted for the purposes of appellees' cross-motion to dismiss the bill of complaint, in which all the allegations of the bill are taken as true.

Appellees will have an opportunity if they believe the facts support them, to deny such allegations in whole or in part in their answer, and to offer evidence on these issues at the trial, if there be such evidence.

VII.

All appellant's expenses, including those incurred in procuring the exempt income, as well as those incurred in procuring taxable income, are deductible from gross income in calculating that portion of appellant's net income which is subject to the tax.

This point, like the preceding point, is not material in determining here whether the decree below should be reversed or affirmed. It affects only the *amount* of the exempt portion of the tax complained of.

The court below in its opinion (R., 55) said:

> "The facts are not in dispute. The plaintiff is a domestic business corporation subject to be taxed under the New York law as the tax is constitutional. Its income during the year in question consisted in part of $162,588.98 derived solely from copyrights granted by the United States on motion picture films. Its expenses in procuring this part of its income were $49,151.37 leaving its net copyright income $113,437.61."

Since the court below did not rule against appellant's contention, no error has been assigned with respect to the amount of expenses which should be deducted. But, as we are informed, appellees will present that question to this Court, presumably with the hope that this Court, in the event of reversal, will desire to instruct the lower court in its further proceedings.

Without conceding any relevancy to the fact, appellant, by stipulation, amended its bill so as to allege that part of its expenses for the fiscal year, to the extent of $49,151.37, were incurred in procuring the income for which immunity is claimed.

Appellees contend that if the $162,588.88 of royalty income be excluded, the $49,151.37 of expenses in procuring that income cannot be allowed as a deduction.

Appellant contends, on the contrary, as was successfully contended by the tax-payer in *National Ins. Co.* v. *United States*, 277 U. S. 508, at pages 511 and 513, that:

> "* * * the exempted income must be, for purposes of taxation, treated as *non-existent* * * * and that the State * * * cannot annex to the privilege of a *deduction* the surrender or subtraction of the constitutional privilege of tax *exemption*." (Italics ours).

Citing

Terral v. *Burke Construction Co.*, 257 U. S. 529.

Both appellant and appellees necessarily *assume*, for the purpose of discussing this point, that the Court holds that the royalty income may not be included in the measure of the tax. In view of that assumption we think that the above-cited *National Insurance Company* case is exactly in point.

It was there held that the taxpayer was entitled to all statutory deductions *in addition* to the privilege of excluding from its gross income whatever elements of income consisted of income derived from tax exempt sources (in that case interest from exempt state, municipal and United States bonds). The Court said (p. 522):

> "Congress had no power purposely and directly to tax state obligations by refusing to their owners deductions allowed to others. * * * We think that provision of the Act which undertook to abate the 4% (statutory) deduction by the amount of interest received from tax exempt securities cannot be given effect. * * *"

The contention vigorously developed in the dissenting opinion that there is a distinction between imposing a burden and withholding a favor was overruled by the majority of the court, as was the contention that the taxpayer's only complaint (p. 535) was that Congress had not granted it as large an exemption as it had accorded to others receiving no income from tax exempt sources.

By Section 209 of the New York Tax Law the Franchise Tax is based on the corporation's net income,

> " * * * which entire income is presumably the same as the entire net income which such corporation is required to report to the United States."

Section 23 of the federal Revenue Act of 1928 provides as follows:

"In computing net income there shall be allowed as deductions:

(a) *Expenses—all* the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *"

It will be noted that the above-quoted provision of the federal statute—adopted by the state statute—in no way distinguishes between expenses incurred in procuring *non-taxable* income from expenses incurred in procuring *taxable* income. On the contrary, the statute, without qualification, allows the taxpayer, in computing its net income "*all* the ordinary and necessary expenses paid or incurred during the taxable year."

It is, of course, an elementary principle of the construction of tax statutes that every doubt and ambiguity is to be resolved in favor of the taxpayer.

Gould v. *Gould*, 245 U. S. 151, 153;
U. S. v. *Field*, 255 U. S. 257;
Smietanka v. *Savings Bank*, 257 U. S. 391.

It is equally well settled that no burden can be imposed upon a taxpayer, and no statutory exemption, deduction or privilege *withheld* from a taxpayer by implication, or by so-called "equitable" construction. The taxpayer is in every case entitled to the benefit of the letter of the statute.

U. S. v. *Merriam*, 263 U. S. 179.

The plain language of the statute accords to the taxpayer a deduction equal to the full amount of all its ordinary and necessary expenses.

The federal constitution, as we contend and as is assumed for the purposes of this point, accords to the taxpayer a complete exemption from the measure of the tax of that portion of its gross income which consists of income from federal instrumentalities.

The effect of the constitutional exemption upon the computation of the tax is as though the exempt income were totally non-existent—yet the statutory deduction, being in no wise limited to expenses incurred in the procuring of non-taxable income, is something to which the taxpayer is entitled under all circumstances—and which cannot be withheld from the taxpayer by departing from the plain language of the taxing statute.

If, as we assume at this point, we have excluded from gross income all such income as is derived from federal instrumentalities, then there is no further constitutional limitation upon the State of New York as to its use of the remaining income, *whether gross or net,* as the basis of the tax.

The state may (so long as it does not infringe on constitutionally exempt income) measure its tax by gross income (as in the Wisconsin tax considered in *Northwestern Mutual Life Insurance Co.* v. *Wisconsin*, 275 U. S. 136) or it may measure the tax by the corporation's *net income*, as in the case of the New York tax and the tax of many other states.

In either case the federal constitution is not brought into question, so long as income from federal instrumentalities is not used as a measure of the tax. With that sole qualification, it is a matter for the state legislature to determine what, if any, *deductions* are to be permitted to the taxpayer. The legislature may decide not to allow any deductions whatsoever and to measure the tax by *gross* income (so long as exempt income be excluded), or it may pick and choose what particular deductions it will allow.

The New York legislature might, for example, have limited the deductions to expenses incurred in the procuring of *taxable income. But it has not elected to do so.* It has allowed the taxpayer the same deductions that is allowed by the Federal Revenue Act, viz.: a deduction for *all* the ordinary and necessary expenses—not limited to expenses in procuring *taxable* income.

Section 23, subdivision b of the federal act, which denies to the taxpayer a deduction for interest on indebtedness incurred in the purchase of tax-exempt bonds will perhaps be cited by appellees. Instead of supporting the appellees' contention, it seems to us that this statutory reference, on the contrary, supports the appellant's contention, because it emphasizes the fact that an express provision of the statute is needed in order to deny to the taxpayer the benefit of a deduction for expenses involved in the production of non-taxable income.

We submit that it is obvious, and must be conceded, that if it were not for the exception contained in Section 23-b of the federal Revenue Act the taxpayer would be entitled not only to exclude from the gross income the interest received by him from federal bonds, but would *also* be entitled to include as part of his statutory deduction the interest paid by him in purchasing or carrying such tax-exempt bonds.

The reason he may not do the latter is that an express provision of statute forbids him to.

If the appellees could point to a specific provision of the statute (as they can in the case of interest in carrying tax-exempt bonds) denying to the taxpayer the benefit of a deduction for *other* expenses incurred in the producing of income from a tax-exempt source, there might be some point to their contention, but in the absence of such specific provision of statute, the appellees must need fall back on construction, implication, and straining of plain language, all of which are excluded by the well-settled rule (above referred to) that no burden may be imposed upon or deduction, exemption or privilege withheld from, the taxpayer by statutory construction involving departures from the express language of the act.

Appellees may argue that if the taxpayer's constitutionally exempt income be excluded from the measure

of the tax without a corresponding denial of the deduction expressly allowed by statute, the result might be to relieve the taxpayer "* * * from the payment of *any* tax although it had enjoyed privileges granted by the state." Such would in no event be the result of the application of what we consider obvious principles of constitutional immunity and statutory construction, because every corporate taxpayer, if there be no net income available for the measure of its tax, is subjected to a tax at the rate of one mill upon every dollar of its issued capital stock under Section 214, subdivision 8, of the New York Tax Law, or a tax at the rate of two percentum on salaries and other compensation paid to all its elected or appointed officers and to any stockholders owning in excess of 5 per centum of the issued capital stock of the corporation, under subdivision 10, *whichever would result in the largest amount of tax.*

Thus, by no possibility, can this taxpayer or any other corporate taxpayer escape the payment of a substantial tax to the state of New York.

Appellant contends merely that the state must have regard for plain and well-established constitutional principles in measuring the tax, and if it be necessary to correct its taxing system so as to adjust the permissible deductions to the operation of federal immunities, it must do so by *legislation* directed to that end, and not by appeal to the courts to render aid to the taxing power, which the legislature has failed to render.

We respectfully submit, therefore, that this taxpayer is entitled to have its entire royalty income excluded from the measure of the tax, and is nevertheless entitled to the benefit of the full deduction allowed by it by Section 209 of the New York Tax Law, referable to Section 23, Subdivision a, of the federal Revenue Act of 1928.

VIII.

Since the New York Tax Law does not furnish an adequate legal remedy for the recovery back of the tax, if paid, injunctive relief is appropriate.

While disputing the merits of appellant's constitutional contention, neither the appellees nor the Court below have questioned that this suit for injunction is an appropriate means for asserting that contention.

We of course realize that, regardless of the merits of his constitutional assertion, a taxpayer is not entitled to injunctive relief until he has first asserted his rights before the appropriate taxing authorities and exhausted his administrative remedy (where one is provided).

> *Gorham Mfg. Co.* v. *Tax Commission*, 266 U. S. 265.

Appellant in this case asserted its constitutional rights, clearly and specifically, in its return, with a sworn statement of the relevant facts (R., 42, 48, Exh. B, opp. R., 40) and its contentions were definitely overruled by the Tax Commission not only in this case of the appellant, but, as an announced policy, in all cases presenting the identical constitutional question (R., 9, 48); so that appellant, under the authorities, was not, as a condition of injunctive relief, required to make a further, necessarily futile, application to the Tax Commission for a revision of the assessment, which would have been an idle form.

> *Montana Bank* v. *Yellowstone County*, 276 U. S. 499, 505;
> *Munn* v. *Des Moines Bank*, 18 F. (2d) 269, 274;
> *Procter & Gamble Co.* v. *Sherman*, 2 F. (2d) 165, 167.

In the *Gorham* case (266 U. S. 265, *supra*) the taxpayer had not availed itself of its administrative remedy. In that case this Court decided against the taxpayer, on the merits, as to the constitutional question and also said, *obiter dictum*, that the bill was properly dismissed by the District Court because of the failure of the company to avail itself of the administrative remedy provided by the statute for the revision and correction of the tax.

However, as was emphasized by the Court, the company "*did not report* to the commission any of the facts upon which it now challenges the validity of the tax". The Court said that "*under these circumstances* the company having failed to avail itself of the administrative remedy was not entitled to maintain a bill in equity."

Furthermore, after the present suit was commenced and before it was heard below, the Tax Commission offered appellant a hearing, and a hearing was had, and the assessment was affirmed (R., 51, 52).

There seems to be no doubt, or controversy, as to the inadequacy of the legal remedy furnished to the taxpayer by the New York Tax Law for the recovery back of his tax after he has once paid it.

There are at least *four* different respects in which the remedy at law afforded by the New York Tax Law to an aggrieved corporation taxpayer is inadequate, any *one* of which would alone be sufficient to show the taxpayer to be entitled to equitable relief. The statutory remedy at law is inadequate because

1. although payment is a condition precedent of judicial review no interest is allowed;

2. even though the Court should hold the tax illegal, refund cannot be compelled as a matter of certain, legal right;

3. the remedy is not available in the federal courts; and

4. the procedure is not prompt and practicable but is, particularly in actual practice, dilatory, burdensome, impractical and uncertain.

The remedy afforded by the statutes of New York State to a corporate taxpayer who complains that a franchise tax assessed against it under Article 9-A of the Tax Law is illegal, is found in Sections 218, 219, and 199.

Under Section 218 the corporation may within one year from the "auditing and stating of the account" (notice of assessment) apply to the state tax commission for revision, and the commission shall grant a hearing thereon. Under Section 219 the commission's determination may be reviewed in the manner (certiorari) prescribed by and subject to the provisions of Section 199.

(It should be noted that before certiorari can be granted to the taxpayer the commission must first have granted a hearing, and then have made its determination, conditions precedent which are not within the control of the taxpayer and which we shall discuss below.)

Under Section 219 the full amount of the tax, interest and other charges audited and stated in such account *must be deposited* with the commission *before making the application* (for certiorari), and an undertaking must be filed for the payment of costs in the prosecution of the writ, and all appeals.

From the determination of the Supreme Court an appeal, under Section 199, may be taken to the Court of Appeals by either party.

If the determination of the Court of Appeals is adverse to the taxpayer, and it claims a violation of its

rights under the federal constitution it may then seek redress in the United States Supreme Court, but only after (a) being granted a hearing by the commission, (b) obtaining a determination by the commission, (c) depositing the tax and filing an undertaking, (d) certiorari proceedings in the Supreme Court, and (e) review by the Court of Appeals.

If the taxpayer, pursuing the foregoing remedy shall ultimately succeed in obtaining a final judicial determination in its favor, the judgment will not be a judgment for the recovery of the deposited tax, but merely, under Section 199 a judgment that "the accounts reviewed shall then be corrected and restated."

Having, let us assume, been successful in the courts the taxpayer's chance of actually *obtaining refund* now depends upon the language of Section 219-d, which so far as here material provides as follows:

> "If from such reassessment it appears that such corporation shall have paid under this article an excess of tax for the year for which such reassessment is made, the tax commission shall *credit* such corporation with such amount. Such *credits may be assigned* (to another taxpaying corporation) * * * or, the amount of such credit, *without interest*, MAY *be refunded* to such corporation out of any revenues received under this article, to the credit of the state comptroller, *at the direction of the state tax commission.*" (Italics ours).

1. *The denial of interest is alone enough to entitle plaintiff to equitable relief.*

The taxpayer cannot obtain judicial relief without first depositing the tax, *with interest* (Section 219-d).

But any refund that it "*may* at the direction of the state tax commission" obtain, if the courts hold the tax illegal, will be *without interest*. The taxpayer will thus surely lose not only the interest deposited, but also all interest on its money from the time of the deposit until the uncertain date of refund.

And in the meantime the taxpayer will be obliged to wait until the commission grants it a hearing, and thereafter until the commission makes a determination, and thereafter (in all likelihood) until *three* courts have successively passed on its constitutional rights. The loss of interest will be substantial and irremediable.

The denial of interest alone entitles plaintiff to injunctive relief. With respect to that feature of the New York tax law, Judge Learned Hand in *Procter and Gamble Distributing Co.* v. *Sherman,* 2 F. (2d) 165, 166, said:

> "But, quite independently of such doubts, (as to certainty of refund) the relief is inadequate because of the express refusal to allow interest. It is no answer to say that interest is not allowed against the sovereign. * * *. The adequacy of the requisite legal remedy cannot be measured by the remedies one has against a person who is exempt from all process. If that were the test, the principal itself might be confiscated. While I have been referred to no decision on the point, it seems to me plain that it is not an adequate remedy, after taking away a man's money as a condition of allowing him to contest his tax, merely to hand it back, when, no matter how long after, he establishes that he ought never to have been required to pay at all. Whatever may have been our archaic notions about interest, in modern financial communities a dollar today is worth more than a dollar next year, and to ignore the interval as immaterial is to contradict well-settled beliefs about value. The present use of my money is itself a thing of value, and if I get no compensation for its loss, my remedy does not altogether right my wrong."

The decision in the *Procter and Gamble* case was approved and followed by the Circuit Court of Appeals for the 9th Circuit in the *Southern California Telephone Co.* v. *Hopkins*, 13 F. (2d) 814, aff'd. 275 U. S. 393, which held that the California statute which was then in effect (1926) did not afford the taxpayer an adequate remedy at law because it did not allow *interest* on the refund (citing *Birch* v. *Board of Supervisors*, 191 Cal. 235; 215 Pac. 903).

Subsequent to the holding of this Court that the California statute did not afford an adequate remedy at law because it did not allow interest on refunds, the California statute has been amended so as to include express provision for interest on refunds (Cal. L., 1929, Chap. 13, §27).

2. *The tax remedy under the New York Tax Law is inadequate since it does not, if successful, lead, as a matter of certain legal right, to the refund of the tax.*

As we have pointed out (*supra*) all that the tax-paying corporation accomplishes under the New York Tax Law, when it establishes in the courts the illegality of the tax, is that it receives a *credit* for the tax.

If, by chance, the tax for the next year, or the next two or three years in the aggregate, equals the amount of the illegal tax already paid, then the *credit* may have *some* value—though long deferred, and without interest.

But it may happen, and usually does, where a tax has been held illegal by the Courts, that next year's taxes (now legally assessed, we may assume) will be less, so as to take an indefinite number of years to "work off" the credit—or the corporation may go out of business. Under those circumstances a *credit* would be very far indeed from being the equivalent of a *refund*.

True, the corporation may *assign* its credit to another corporation.

But where is the *market* for buying and selling these credits? What advantage would the buyer have to inject itself into some other corporation's tax complications unless it could buy at a substantial discount?

Obviously, the *credit* which the corporation receives, after winning its case in the courts, is in effect *depreciated currency*. It is far different from a cash refund.

It must be admitted, of course, that "at the direction of the state tax commission" the amount of the credit, without interest, "*may* be refunded to the corporation" under Section 219-d of the Tax Law, and no doubt such refunds are frequently made.

But not only is there no decision of the court of last resort that "may" means "must" in that connection, but the succeeding language of 219-d shows that the actual cash refund to the taxpayer, besides being "at the direction" of the commission is contingent on the existence and amount of "*current* revenues credited to such taxing district" with the alternative of waiting for "*further* revenues credited to such taxing district", presumably in subsequent years.

In the only cases in which, so far as we can find, the effect of that feature of the New York Tax Law has been considered, it was held that the failure of the statute to direct a refund as a matter of right, makes the remedy *inadequate*.

In *Gorham Mfg. Co.* v. *Travis*, 274 Fed. 975, it was said (p. 976):

> "(1) The first question is of jurisdiction in equity. I should have thought the provisions for revision by the tax commission and certiorari to the Supreme Court adequate remedies at law, *Indiana Mfg. Co.* v. *Koehne*, 188 U. S. 681, 23 Sup. Ct. 452, 47 L. Ed. 651; *Boise, etc., Co.* v. *Boise*, 213 U. S. 276, 29 Sup. Ct. 426, 63 L. Ed. 796; *Dalton*

Machine Co. v. *Virginia*, 236 U. S. 699, 35 Sup. Ct. 480, 59 L. Ed. 797, except for one thing. Before applying for the writ, the taxpayer must 'deposit' the tax with the State Comptroller (Section 219), and there is no provision for getting it back. It is indeed a little strange that there should be doubt about this, but the only reported case, *In re Waterman*, 33 Misc. Rep. 569, 68 N. Y. Supp. 892, is flatly against any recovery. That was decided 20 years ago, and in spite of the suggestion there contained the Legislature has never seen fit to give power to a court to direct the Comptroller to pay back the money. The defendants say that the Appellate Divisions have frequently so decided, but they cite no cases. When a tax statute expressly directs the Comptroller to refund, it is true that the courts will compel him to do so, *People ex rel. Millard* v. *Chapin*, 104 N. Y. 100, 10 N. E. 141; *People ex rel. Ostrander* v. *Chapin*, 109 N. Y. 177, 16 N. E. 331, and such an act is constitutional, *People ex rel. Evans* v. *Chapin*, 101 N. Y. 682, but here there is no act. The matter at best rests in inference. The situation is therefore closely analogous to *Dawson* v. *Kentucky, etc., Co.*, 255 U. S. 288, 41 Sup. Ct. 272, 65 L. Ed. 638, Supreme Court, February 28, 1921, where indeed there was a statute directing a refund, though the state authorities were ambiguous. That case I think rules, and shows that here an adequate remedy at law is not clear enough."

In the *Gorham* case, *supra*, this court, after holding the state remedy inadequate, dismissed the suit on the merits, and the judgment was affirmed (266 U. S. 265) without in any way affecting Judge Hand's ruling that the Tax Law does not furnish an adequate remedy at law.

For the same reason this Court in *Dawson* v. *Kentucky Distilling Co.*, 255 U. S. 288, held that a certain Kentucky statute did not afford the taxpayer an adequate remedy at law because, in the absence of an authoritative

interpreting decision, it was *uncertain* whether or not the taxpayer could compel the refunding of the tax after the courts had established its illegality.

Even though the Kentucky Court of Appeals, between the filing of the bill and the hearing in this Court, interpreted the statute favorably to the taxpayer, nevertheless the taxpayer's right to equitable relief was upheld on the ground that, at the time the bill was filed, the taxpayer's right was not clear and certain.

The question was presented again in 1924 in *Procter and Gamble Co.* v. *Sherman*, 2 F. (2d) 165, and again it was held that the remedy is not adequate, for the same reason, as well as for the reason that no interest is allowed (which we discuss below). The Court said, at page 166, with reference to the point now under consideration:

> "* * * section 218 of the New York Tax Law, even as amended (Laws 1920, c. 640, §7, Laws 1921 c. 443, §8; Laws 1922, c. 507, §5) does not, in my judgment, give an adequate remedy at law. While the word 'may' in the clause 'may be refunded to such corporation', probably refers to the taxpayer's option, that is, he may either assign the credit or get the cash, the phrase 'at the direction of the state tax commission' is to me ambiguous. The language as a whole leaves it uncertain whether the taxpayer could compel a refund, if the commission opposed him. * * * "

Uncertainty, under the statute, of right to compel refund was held to be a ground for equitable relief in *Hopkins* v. *Southern California Tel. Co.*, 275 U. S. 393, at page 399.

3. *The New York remedy by certiorari is inadequate because it is not available in the federal courts.*

It is well settled that a remedy at law for the recovery back of a tax illegally exacted is not adequate unless it is available to the taxpayer (assuming the existence of

a federal question or diversity of citizenship) in the *federal* courts.

> *Chicago B. & Q. R. R. Co.* v. *Osborne*, 265 U. S. 14;
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> *Bohler* v. *Calloway*, 267 U. S. 479;
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> *Risty* v. *Chicago etc. Co.*, 270 U. S. 378, 388;
>
> *So. Ry. Co.* v. *Query*, 21 F. (2d) 333 (E. D. S. C.);
>
> *Henrietta Mills* v. *Rutherford Co.*, 32 F. (2d) 570, C. C. A. 4th.
>
> *Munn* v. *Des Moines National Bank*, 18 F. (2d) 269, C. C. A. 8th.

Even though the taxpayer's rights under the United States constitution be violated or there be diversity of citizenship, or both, the New York remedy at law (by certiorari) is obviously not available in the federal courts. Therefore, under the well-established rule, it is not such "adequate remedy at law" as will prevent equitable relief by injunction.

The remedy at law in South Carolina is by *mandamus*. That was held inadequate in *Southern Ry. Co.* v. *Query* (*supra*).

For the same reason the remedy at law in North Carolina was held inadequate in *Henrietta Mills* v. *Rutherford County* (*supra*) in which the Circuit Court of Appeals for the Fourth Circuit said (p. 572):

> "Furthermore, it is well settled that a federal court of equity may properly interfere to restrain the violation of a taxpayer's rights by an unconstitutional exercise of the taxing powers, unless there be a plain, adequate, and complete remedy at law available to the taxpayer *in the federal court*. *Cummings* v. *Merchants National Bank of Toledo*, 101 U. S. 153, 157 (25 L. Ed. 903); *Raymond* v. *Chicago, etc., Co.*, 207 U. S. 20, 28 Sup. Ct. 7; *Southern Ry. Co.* v. *Query*, (D. C.), 21 F. (2d) 333; *Chicago, B. & Q. R. R. Co.* v. *Os-*

borne, 265 U. S. 14, 44 Sup. Ct. 431; *Risty* v. *Chicago R. I. & P. R. Co.*, 270 U. S. 378, 388, 46 Sup. Ct. 236; *Bohler* v. *Callaway*, 267 U. S. 479, 45 Sup. Ct. 431." (Italics ours.)

This Court in *Risty* v. *Chicago B. & Q. R. R. Co.* (*supra*) said (p. 388):

> "* * * the test of equity jurisdiction in a Federal court is the inadequacy of the remedy on the law side *of that court* and not the inadequacy of the remedies afforded by the state courts. *Smyth* v. *Ames*, 169 U. S. 466; *Chicago B. & Q. R. R. Co.* v. *Osborne*, 265 U. S. 14.
>
> "It does not appear that the state law affords a remedy by payment of the assessment and suit to recover it back, which, if it exists, can be availed of in the Federal courts. *Singer Sewing Machine Co.* v. *Benedict*, 229 U. S. 481, 486." (Italics ours.)

In *Chicago B. & Q. R. R. Co.* v. *Osborne* (*supra*) this Court said (p. 16):

> "* * * a remedy in the state courts only has been held not to be enough."

4. *The remedy at law afforded by the New York Tax Law is not as practical, efficient and prompt as the remedy in equity.*

The *conditions precedent* to obtaining a writ of certiorari under the New York Tax Law—particularly as it is applied in practice—are such as to make the remedy dilatory, uncertain, impractical, inefficient and burdensome (R., 8, 9, 48).

It is an absolute condition precedent to obtaining judicial relief that the taxpayer must first succeed in persuading the State Tax Commission to grant a formal hearing (no matter how definitely it has ruled against the taxpayer), and must thereafter persuade the commission to make its formal determination thereon.

Those conditions precedent are beyond the control of the taxpayer, and, as the affidavits show, hearings are in practice indefinitely and arbitrarily postponed, with no assurance of relief.

The attitude of the federal courts on that question is well typified by the opinion of the Circuit Court of Appeals (Eighth Circuit) in *Munn* v. *Des Moines Bank*, 18 F. (2d) 269 (*supra*). The Court said (pp. 271-272):

> "The adequate remedy which will prevent the maintenance in this court of equity of these suits must be 'as practical and efficient to the ends of justice and its prompt administration, as the remedy in equity'. *Boyce* v. *Grundy*, 3 Pet. 210, 215; *Oelrichs* v. *Spain*, 15 Wall. 211, 228; *Hayden* v. *Thompson* (C. C. A.), 71 Fed. 60, 63; *Walla Walla* v. *Walla Walla Water Co.*, 172 U. S. 1; *St. Louis Ry. Co.* v. *McElven*, 253 Fed. 123, 135. Such a remedy must also be a legal remedy in the federal court, not merely in a state court. *National Surety Co.* v. *State Bank* (C. C. A), 120 Fed. 593; 61 L. R. A. 394; *Brun* v. *Mann* (C. C. A.), 151 Fed. 145, 12 L. R. A. (NS) 154; *Franklin* v. *Nevada Power Co.* (C. C. A.) 264 Fed. 643, 645."

CONCLUSION.

The decree of the District Court should be reversed, with leave to defendants-appellees to plead over, and an interlocutory injunction should be granted restraining the collection of the tax complained of to the full extent demanded in the bill of complaint, viz. to the extent of $7,316.51.

Respectfully submitted,

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